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Supreme Court of the United States

OCTOBER TERM, 1949

ATLANTIC COAST LINE RAILROAD COMPANY, et al. *Petitioners,* vs. ST. JOE PAPER COMPANY, et al., *Respondents.*	No. 601

REPLY BRIEF OF RESPONDENT F. K. CONN TO PETITION FOR A WRIT OF CERTIORARI TO THE FIFTH CIRCUIT

I.

The Petitioners Have Misinterpreted the Decisions of This Court with Respect to the Respective Functions of Court and Commission under Section 77.

In the petitioners' statement of the questions (Petition, p 3) and the discussion of those questions (pp 16-22), there is a clear misapprehension of the purport of the decisions in both the District Court and the Court of Appeals; and there is an equally clear misunderstanding of the decisions of this Court on the subject. We believe that we can best demonstrate this statement by a positive approach:

(1) The decisions of this Court are clear and unmistakable in deciding that Section 77 of the Bank-

ruptcy Act gave the District Court definite discretionary authority in connection with the approval or disapproval of reorganization plans.

(2) The District Court correctly interpreted and applied the decisions of this Court.

(3) The majority in the Court of Appeals correctly decided that the District Court properly exercised the discretionary authority of disapproval.

If the above statements are correct, then there is no necessity for granting certiorari merely for the purpose of further demonstration, and the writ should be refused.

1. Under the decisions of this Court, the District Court has discretionary authority with respect to certain functions in the approval of a plan.

These areas of judicial authority were thoroughly examined in *Ecker v. Western Pacific R Corp.*, 318 US 448 and *Group of Institutional Investors v Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 US 523, as stated in the Petition (p 16). But it is incorrect to say, as does the petition (pp 16-17), that "the holdings in the *Western Pacific* and *Milwaukee* cases were summarized in the first *Denver* case (328 US 509):

> 'To the Courts, Congress confided the power to review the plan to determine whether the Commission has followed the statutory mandates of subsection (e), 318 US at 477, and whether the Commission had material evidence to support its conclusions. 318 US at 477; concurring opinion at 512'."

For it is apparent from a reading of the *Denver* case and the citations referred to in the quoted sentence, that this Court was referring *only* to the function of *valuation*—that is, the quoted sentence refers only to the

fourth paragraph of Section 77(e) (Petition, appendix iii) and *not* to Section 77(e) as a whole.

With regard to Section 77(e), this Court has determined, principally on the basis of its legislative history, that the Bankruptcy Act reserved certain functions to the District Court, comparable to those it exercised in equity receiverships, and which it presumably should perform in the same manner:

> "The first bill was introduced in the House January 21, 1933, as H. R. 14359. It was drafted so as to place 'the entire plan of reorganization under the jurisdiction, supervision and control' of the Commission. After Commission approval, which followed stockholder and creditor approval, it was to transmit the 'approved plan, its findings and the record to the court. The court's review must be based upon the record made before the Commission.' This substitution of the Commission for an equity receivership under court direction was criticized and amendments suggested to 'eliminate all confusion in regard to the functions to be exercised by the Commission and by the court . . and [to] remove the most fundamental objections to the bill in its present form.' Nothwithstanding the criticism the bill passed the House with the power lodged in the Commission, as originally proposed. When the House bill for the relief of debtors was reported by the Senate Committee, the railroad section was omitted. By a motion from the floor it was reinstated but in a changed form. *The Senate adopted changes designed to give more power to the court.* 76 Cong. Rec. 4907, 5104-34. Hearings before the court were provided. The judge, it was added, was to be 'satisfied that (1) the approved plan complies with the provisions of subsection (b) of this section, is equitable and does not discriminate unfairly in favor of any class of creditors or stockholders.' These amendments giving concurrent powers to the

court were adopted by the Senate and accepted by the House and the bill became the Act of March 3, 1933, 47 Stat 1474, c 204, 11 USCA § 205, 3 FCA title 11 § 205.

"Following the recommendation of the President in his message of June 7, 1935, the Congress adopted amendments to the 1933 act which were in line with the suggestions of the Federal Coordinator of Transportation and the Commission. While the most important amendment was to furnish means to avoid the obstruction of dissatisfied classes of creditors or stockholders by making a fair and equitable plan effective over dissenters, the requirement of coordinated action by Commission and court was retained." (emphasis supplied) *Ecker v. Western Pacific R. Corp.* 318 US 448, 469-471, 87 L ed 892, 930-931.

Participation of both court and the commission or other regulatory body in equity reorganizations was not uncommon (see discussion, Tracy, *Corporate Foreclosures,* pp 346-348). The 1933 Act principally changed the burden of the preparation of the plan and the manner of its submission to court, commission and creditors for approval. Certainly there is no authority for the suggestion that the 1933 Act changed the ordinary meaning of the words "if satisfied" as applied to the Court's determination necessary to its approval.

These words were not new to equity receiverships, and they were not new to bankruptcy law. The same statement appeared, for example in Section 12 of the Act of 1898 (11 USCA § 30) relating to confirmations of compositions:

"(d) The judge shall confirm a composition *if satisfied* that (1) it is for the best interests of the creditors; (2) the bankrupt has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to his discharge; and

(3) the offer and its acceptance are in good faith and have not been made or procured except as herein provided, or by any means, promises, or acts herein forbidden." (emphasis supplied).

This section was revised into separate chapters by the *Chandler Act* (52 Stat. 840), and comparable statements concerning Real Property Arrangements, (Chapter XII), Wage Earner Arrangements (Chapter XIII) and Arrangements generally (Chapter XI) appear as Sections 467, 472, 656, 361 and 366, respectively, of the present *Bankruptcy Act* (11 USCA 867, 872, 1056, 761, 766).

There has never been any doubt that the words "if satisfied" in those sections mean what they say—that is, that the Court, exercising a discretionary judicial function, must find the facts to support his prescribed action, or in the absence of such finding, disapprove the plan.

"While consent to a bankrupt's offer of composition by a majority of his creditors in number and amount is evidence that it is for their best interest, In re Waynesboro Drug Co. (D.C.) 157 F. 101; In re Hoxie (D.C.) 180 F. 508; In re Barde (D.C.) 207 F. 654, and therefore properly to be considered by the judge in passing on the question, such evidence being only prima facie is not controlling upon him for, after all, it is upon the judge that the Bankruptcy Act places the duty of deciding whether the offer is for the best interests of the creditors, and this independently of their favoring a composition. Cases supra. Such a decision rests wholly within his discretion. This court will not on appeal disturb the action of a district judge based on his discretion unless it clearly appear that he has abused his discretion or has grounded his action on a plain mistake of fact."

In re Youtie (CCA 3), 44 F 2d 56

A comparable provision also appears in Chapter X (and previously in Section 77 (B)) of the Bankruptcy Act, applicable to the Court's confirmation of plans under that Chapter (Section 221, 11 USCA § 621). "The judge shall confirm a plan *if satisfied . . .* " concerning five designated subjects. Under that wording—

> "The approval of the plan, if authorized by the necessary number of creditors, is a matter which must lie largely in the discretion of the trial court, with which discretion we should be very reluctant to interfere, and indeed would have no power to do so except in the case of plain abuse of discretion, which is not shown in the case at bar."
> *In re Pilsener Brewing Co.,* (CCA 9, 1935) 79 F 2d 63, 68.

> ". . . the matter which we are asked to review is the action of the court in approving the plan. The court found the plan to be fair and equitable. We can not say that the plan proposed by appellant is more fair and equitable than the plan proposed by the committee. The lower court, well acquainted with all the facts bearing upon that question, and hence peculiarly well qualified to determine the comparative fairness of the two plans, has found in favor of the committee's plan, and specifically found that, 'The alternative plan submitted by Scherck, Richter Company is not fair and equitable, and does not afford due recognition to each class of holders of certificates of deposit and creditors, stockholders and holders of voting trust certificates of Ambassador Building Corporation.'
>
> "The question presented to the lower court was under the circumstances disclosed by this record, a question of business policy calling for the exercise of business judgment. Its decision should not be disturbed in the absence of an abuse of discretion.

Warner Bros. Pictures v. Lawton-Byrne-Bruner Ins. A. Co., [79 F 2d 804]; Kansas City Terminal Ry. Co. v. Central Union Trust Co., 8 Cir., 28 F. 2d 177; Mercantile Trust Co. v. Farmers' Loan & Trust Co., 8 Cir., 81 F. 254; Reconstruction Finance Corp. v. Kentucky River Coal Corp., 6 Cir., 114 F. 2d 942."

Scherck Richter Co. v. Dysart, (CCA 8, 1941) 123 F 2d 364, 369

This Court in *Ecker v. Western Pacific R. Corp.,* 318 US 448, 510, specifically affirmed the opinion of the District Court, and approved the functions of that court, which it described as—

"Upon the other findings [than valuation and the amount and character of the capitalization] of the Commission, the District Court exercised an independent judgment based upon the record and the findings of the Commission together with additional evidence produced before the court by the parties. 34 F Supp 493, 505." (at 467)

In that case the District Court included, among its other determinations, the following:

"The determination of the questions relating to the distribution of the new securities, including legal priorities and allocations, involves private rights and is a judicial function, within the province of the court. However, since these private property rights had not been adjudicated, it became the duty of the Commission to determine them preliminarily for the purpose of considering the plans before it. 230 I.C.C. 61, 97. Without such consideration and determination, it would have been impossible for the Commission to have complied with the statute and certified a plan to the court. While the decision of the Commission in the premises is advisory only, it was of inestimable value to the court in enabling it to see the whole picture and arrive at a decision."

In re Western Pac. R. Co., 34 F. Supp. 493, 504.

And in *Institutional Investors v. Chicago M. St. P & P.*, 318 US 523, this Court specifically declined to overturn the discretionary act of the *District Court* (not the Commission) in approving an allocation of securities.

> "No fixed rule supplies the method for bringing two divisional mortgages into a new capital structure so that each will retain in relation to the other the same position it formerly had in respect of assets and of earnings at various levels. The question in each case is one for the informed discretion of the Commission and the District Court. We cannot say that that discretion has been abused here.
>
> *"We would have quite a different problem if the District Court had failed to perform the functions which* § 77 (e) *places upon it.* But it cannot be said that there was any such failure here. The District Court satisfied *itself* that the principles of priority as applied to these facts were respected. See 36 F. Supp pp. 202, 203, 211, 212. Since such a determination rests in the realm of judgment rather than mathematics, there is an area for disagreement. But we are not performing the functions of the District Court under § 77 (e). Our role on review is a limited one. It is not enough to reverse the District Court that we might have appraised the facts somewhat differently. If there is warrant for the action of the District Court, our task on review is at an end." (emphasis supplied) (at pp 563-564)

In this respect, Mr. Justice Roberts in dissent considered that the majority opinion had gone too far. "The opinion of the court treats this question as, in effect, lying within the sound discretion of the district judge and refuses to review his action on the ground that it is not evident he abused that discretion." (at p 577) But the majority opinion is still the rule of this Court.

2. The District judge correctly applied the decisions of this Court.

It is evident that the Judge Designate was acquainted with his duties, and followed the statutory functions assigned to him (R 472-475); and he properly considered that he should "independently consider those matters which the statute requires me to be satisfied about, in the light of the new evidence concerning them" (R 475).

Having given independent consideration to such matters, the Judge Designate drew his conclusions, and among them:

> "I conclude also that the plan is not fair and equitable and does not afford due recognition to the rights of the refunding bondholders." (R 479)

There is a wealth of evidence to support such a finding, but two points raised by the Court are sufficient:

> (1) The Coast Line, "an unsecured creditor [but] . . . really a stranger in interest" is getting the railroad, while the old security holders are receiving new securities of dubious present value. (R 479) "The very aggressiveness of the Coast Line in proposing and defending this plan indicates that the Coast Line thinks it is getting a bargain; that what it gets is not the mere equivalent of what it pays, but much more." (R 480) This is obviously a violation of the absolute priority rule.
>
> (2) The subservience of the rights of minority Bondholders to the exigencies of the struggle between the Coast Line and St. Joe Paper Company as a majority bondholder, which requires that "all must sell their equitable rights in this property, and must take in exchange that which is not money and which they do not desire to have . . . [is] unfair,

inequitable, and not a due recognition of their rights." (R 478)

The error of the petitioner Atlantic Coast Line seems to be in a failure to recognize its own position in this controversy. It seems singularly naive to seriously suggest that, because it has no interest in the proceedings, the fact that it is to receive the entire railroad property, rather that an allocation of the available securities, is no violation of the absolute priority rule. It is, in fact, the ultimate infraction of the doctrine. Whatever the "covetous one" (R 943) gets is obviously misallocated out of the total. And the allocation is peculiarly the discretionary function of the court, and not of the commission.

3. The majority in the Court of Appeals correctly interpreted the law and affirmed the District Court's order.

Judge Hutcheson's analysis of the case closely followed the points in the Judge Designate's opinion referred to above—it was he who correctly stigmatized the Coast Line as the "covetous one" (R 943).

And the majority also correctly analyzed the functions of the court in allocating the properties of the debtor. "It is quite clear, too, that, in reviewing the findings of the trial judge upon such a record, it would be our duty to accord full weight to his conclusions that the plan was not fair and unless they are found, as a matter of law ,to be wholly wrong, or, as matter of fact, to be clearly erroneous, these conclusions and the order based on them should be sustained." (R 945)

The point that the Court of Appeals majority and the trial judge made, and which the Coast Line has, so

far, seen fit to ignore, is that, in this case, the allocation of the properties of the debtor (a judicial function—*Milwaukee* case at 564; concurring opinion in *Ecker v. Western Pacific* at 513-515) entails more than the mere distribution of the Coast Line securities to the Florida East Coast bondholders. *It also involves the allocation or distribution of the physical properties of the Florida East Coast to the Coast Line.* And if, as both the trial court and the appellate court found, that distribution represented the receipt by the Coast Line of something of value (R 479-480; R 947), then there was a misallocation of the debtor's property and the plan was properly disapproved.

This leaves nothing for this Court to review; for under similar circumstances this Court has held:

> "The findings to that effect are entitled to special weight where, as here, they are based on the District Judge's complete familiarity with the case. *Reconstruction Finance Corp. v. Denver & R.G.W. R. Co.*, 328 US 495, 533, 90 L ed 1400, 1423, 66 S Ct 1282. Affirmed by the Circuit Court of Appeals, *they are, under the rule concerning concurrent findings, and on the basis of our grant of certiorari, conclusive in this Court.*" (emphasis supplied)
>
> *Comstock v. Institutional Investors,* 335 US 211, 230; 92 L ed 1911, 1924.

II.

There is Neither Private nor Public Interest in This Case Warranting the Grant of Certiorari.

The Coast Line, a "railroad company coveting, and pressing to possess, a competing debtor railroad company" (R 943) and "its small but faithful ally, the Deposit Committee" (R 939) ask this Court to grant certiorari. The brief does not clearly set out in which

respects they consider that the trial court and the court of appeals erred as to the facts, and to what extent the error was one of law. If the error, supposing there was one, was an error of law, then it is not stated in what manner the error of law was prejudicial to the private interests of the petitioner.

In this respect, the Coast Line is apparently in a dilemma. If it admits that under the plan it would receive property of a greater value than the securities which it transfers in exchange, then it admits that there has been misallocated to it, a portion of the properties of the debtor. If, on the other hand, under the proposed plan, it was to have transferred securities of a greater value than the property which it received, then the decisions of the trial court and the court of appeals are actually favorable to it and it is in no wise aggrieved. This latter result, of course, seems unlikely, particularly in view of the fact that, as the trial judge found, "no one would contend that the Coast Line could be forced" to complete the transaction (R 476).

In any event, there seems to be no possible way for the Coast Line to show that it is aggrieved without also showing that if the decision were to the contrary, the bondholders would have their property taken for the benefit of the Coast Line, without just compensation (R 944).

As to the Deposit Committee, it is difficult to understand their position except on the basis of the misplaced loyalty that the court of appeals suggested. (R 942, 939) The court of appeals, in effect, found that the bondholders were not receiving all that they were entitled to, and that the case should be returned to the Commission, in accordance with the decision of the trial judge, "for the purpose of working out a really fair and equitable

plan, and without prejudice to a fair acquisition by the Coast Line." (R 948) It is difficult to see how the bondholders of the Deposit Committee could be damaged by the probability of receiving greater value for their securities. One of the primary purposes of the reorganization procedures in the Bankruptcy Court was to avoid such strikes against the opinion of the vast majority of a creditor group by creditors holding relatively insignificant interests.

Nor does there appear to be any significant public interest involved in this case. The term "public interest" refers to the interest of the public generally, and the importance of the question of law which is to be decided by the court if the writ of certiorari is granted. The petition has not suggested any great public interest in the principle of law here to be decided. Quite apart from the fact that the Supreme Court of the United States has already decided all questions of law involved in this case, as we have pointed out above, the importance of any question involving railroad reorganizations is largely past. The significant cases have already gone before the Supreme Court of the United States, some of them more than once, and have been returned to the District Courts and the Commission, where the reorganizations have been confirmed and completed. This case is one of the few which remains before the courts out of the multitude earlier involved in bankruptcy or reorganizations. On October 23, 1939, there were 61,292.69 miles of railroad in bankruptcy proceedings under Section 77, including lines in 29 states. About one-quarter of the railroad mileage of the country was then in bankruptcy (*Palmer v. Massachusetts,* 308 US 88-89, n 16; 84 L ed 100).

As of June 30, 1949, there were only 29 railroad reorganizations in the courts in the entire United States.

Of these at least 25 were over one year old and had presumably, for the most part, passed the phase in which this reorganization bogged down (*Tables of Bankruptcy Statistics,* fiscal year ended June 30, 1949, Administrative Office of the United States Courts). A decision in this case is unlikely to have any important effect on any other railroad reorganization, even if there were some error in the facts or in law in the decision of the court of appeals. And before another crop of railroad reorganizations appear before the courts, it seems probable that the statute may be significantly changed.

Further, both the court of appeals (R 943), and the trial court (R 478-480) found that as this case was handled by the Interstate Commerce Commission, it degenerated into what was largely a private battle between two powerful financial groups, those in control of the Atlantic Coast Line Railroad Company, (presumably the Safe Deposit and Trust Company of Baltimore group (R 312)) and the St. Joe Paper Company, and its underlying owner, the Alfred I duPont Trust Estate (R 313-314). The trial judge significantly found that in the course of this conflict, the rights of other bondholders were subordinated to the private struggle (R 478).

Insofar as the action taken by the district court and the court of appeals is concerned, there has been merely a solution of the private conflict between the Atlantic Coast Line and the St. Joe Paper Company. Furthermore, under the decision of the court of appeals, (R 948) the solution is one which deprives neither of these contestants from a reassertion of their interest, if any, in a fair reorganization. If the Atlantic Coast Line Railroad Company considers that it can act fairly in a reorganization, that is, if it desires to become a purchaser at a fair price to the bondholders, it can make its bid when the

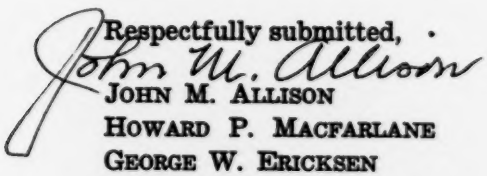
Interstate Commerce Commission is again attempting the formulation of a fair and equitable plan. The St. Joe Paper Company has an equal right to act, subject to the suggestion by the district court (R 480-481) that it may have to subordinate its ownership interests to a direction and control by some more impartial operating organization.

CONCLUSION

We respectfully submit that, in view of the fact that there is no substantial public interest which would warrant the granting of the writ, and in view of the fact that the petition patently relies on a misinterpretation of former opinions of this court, the writ of certiorari should be refused.

Dated March 11, 1950.

Respectfully submitted,



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